WHAT THE ACCOUNTANT SHOULD KNOW ABOUT FEDERAL TRANSFER TAXES

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Very little is ever said or written about the accountant or auditor's role in checking and verifying the Federal and/or State Stock Transfer Taxes required to be affixed when ownership of stock changes in a Corporation. A corporation can be subjected to the payment of a sizeable sum in taxes if proper care is not taken to see that the tax is paid by the person or persons obligated at the time of transfer of stocks and bonds. Who is a better "watch dog" for this than the accountant?

The Commissioner, under Section 3640, Regulations 71 relating to Stamp Taxes under Chapter 11 and 31 of the Internal Revenue Code, is authorized and required to make the inquiries, determinations, and assessments of all taxes and penalties imposed, where such taxes have not been duly paid by stamp at the time and in the manner provided by law. Where assessment is made, and payment is not made within 10 days after the issuance of the first notice and demand, Form #17, there will accrue, under Section 3655, a five per cent penalty and interest at the rate of six per cent per annum computed upon the entire assessment from the date of issuance of the notice until date of payment.

The United States Government requires that transfer tax stamps be affixed to all stock certificates transferred within its jurisdiction unless tax is waived by special provision. In addition to this tax, five states also require that additional transfer tax stamps be affixed to stock certificates transferred within their jurisdiction. These states are: New York, Pennsylvania, Florida, Texas, and South Carolina. Inasmuch as the requirements of the various states vary somewhat, even though they are similar in principle, this article will deal almost exclusively with the regulations governing Federal Transfer Tax.

Banks perhaps more than other Corporations could be subjected to the largest liability in regard to transfer taxes, banks in this instance referring to those having a Corporate Trust Department which in the course of its work transfers stocks of many Corporations in its capacity as Transfer Agent. Even when a Corporation transfers only its own stock, the auditor should be familiar with the methods of computation and the rules and regulations governing same in order that he may make recommendations and take the necessary steps to correct any errors or violations. Certainly when the agent from the Revenue Department comes over to check all stock and bond transactions, the auditor wants him to find as few exceptions as possible. It is not beyond the realm of possibility that he would find none at all if the person or persons responsible for calculating and collecting taxes are well trained in this field. Certainly the tax must be paid. No one can dispute the fact that there is no better time of collecting it than at the time it is due. Even more important, there is no better person to pay it than the one who owes it.

Section 113.2 of U. S. Treasury Department, Bureau of Internal Revenue, Regulations 71, relating to Stamp Taxes, states, "The tax is payable by any of the parties to a taxable transaction. The parties of the transaction may agree among themselves as to which shall pay the tax, but such agreement does not relieve the others from their liability in the event it is not carried out. No provisions, by-laws, or rules, of any exchange, and no custom shall exempt any person from payment of the tax imposed."

Upon first examination of a new Corporation, the accountant should check to see that the proper tax has been paid on all shares of the original issue and on subsequent transfers. Many smaller companies often are not aware of this requirement. In many instances where tax has been paid, the wrong amount has been affixed. It may be too little, in which case additional tax must be paid, or it may be an overpayment, in which case a claim for refund should be made on Form #843.

On continuing audits, the accountant should check the tax on transfers effected since the last audit. Where the volume of transfers is extremely large, the accountant can and usually does limit his audit to a spot check to see if the Corporation is complying with the law.

It is primarily the duty of the accountant to see that procedures are set up for the proper handling of transfer taxes and, secondly, to test check to see that the tax is being paid. If findings of the spot check clearly show that the tax is being carelessly handled in such a way as to impose additional liability on the Corporation, the accountant should pursue the matter further by making a thorough audit of all transactions.

It is the duty of the accountant to bring any violations to the attention of the Corporation, in order that necessary steps may be taken to prevent a recurrence. It may be possible the whole procedure needs revision, and he should make whatever recommendations he considers necessary under the circumstances. Since the tax liability is that of the Corporation, the accountant is concerned that necessary safeguards be instituted to prevent the assessment of additional tax and interest.

Many Corporations maintain a supply of transfer stamps on hand, and these should be inventoried. The stamps and/or cash should be verified immediately by the accountant to see that they balance with the book figures maintained on the stamps.

The accountant's role will be greatly simplified if one or more very responsible employees is assigned the duty of computing and collecting the taxes due. In order to accomplish this duty, the employee must be well versed in the field as to which transactions require payment of tax, those exempt from the tax, the rules regarding computation, the proper cancellation of stamps and all matters pertaining to same. By the same token, the accountant must also be well trained if an effective audit of the records is to be made and any exceptions detected.

We have considered the role of the accountant. Now let us give attention to some of the more important regulations relating to stamp taxes.

On original issues of stock, whether it be upon organization or reorganization, the tax is 11 cents on each $100 of par or face value or fraction thereof of the certificates issued by the corporation. If, however, the certificates are issued without par or face value, then the tax is 11 cents per share, unless the actual value is in excess of $100 per share, in which case the tax is 11 cents on each $100 of actual value or fraction thereof of the certificates, or unless the actual value is less than $100 per share, in which case the tax is three cents on each $20 of actual value, or fraction thereof. A separate computation of tax must be made with respect to each certificate regardless of the number of certificates which may be involved in a single transaction.

The simplest method of remembering the rules regarding computation is to start with the highest par value stock of $100 and no par, and then compute other taxes by a formula. On the $100 par and no par, which carries the highest rate of tax, the tax is five cents for each share if selling price is under $20 per share and six cents for each share if the selling price is $20 or over. On other par values, the rule is (1) Compute total par value of shares sold by multiplying par value per share by number of shares sold, then (2) Divide par value by 100 to determine number of $100 units sold, treating the fractional remainder as a full unit of $100. The rate of tax then is five cents for each unit of $100 if selling price is under $20 per share or if the transfer does not involve a sale, and is six cents for each unit of $100 if selling price is $20 or more per share. For example, if 100 shares of $10 par value stock is sold for $25 per share, then using the formula, you multiply $10 par value by 100, the number of shares sold, which gives you $1,000. Then you divide the $1,000 by 100 to ascertain the number of $100 units sold, which gives you 10, taxed at the rate of six cents per unit, or 60 cents on the 100-share sale. If it were a gift or a distribution, the tax would be 50 cents, figured at five cents per unit. Let's take a second example involving $1 par value stock. A hundred shares of $1 par value stock is sold. Using our formula, again, we multiply $1 by 100, get $100, divide by 100 and get one unit, or tax of six cents.

Where there are two or more transferors or two or more transferees, or where in one transaction a transfer is made of the stock of two or more corporations, or of two or more classes of stock issued by a single corporation, a separate tax computation must be made with respect to each transferor and each transferee and with respect to the stock of each corporation and the stock of each class issued by a single corporation. If for example (1) 100 shares of $10 par value stock is transferred by gift to a single individual, we know from our formula that the tax would be 50 cents, but if under a will this stock is distributed by an executor eleven shares each to nine beneficiaries, which makes a total of 99 shares, and the one remaining share is sold, the tax will be 96 cents, since tax must be computed on each separate transaction. The tax would be 10 cents on each of the eleven-share distributions, since there would be one unit of $100 value and a fractional part of another unit taxed on the same basis as a full unit at 5 cents each (gift or lower rate), and then the one share sale would be six cents, assuming that it was sold for more than $20. Example (2) If 100 shares of $1 par value stock were transferred to an individual, the tax would be five cents (selling under $20) but if the stock was distributed under a will or sold at one share each to one hundred individuals, the tax, computed on each separate and distinct transaction, would be $5.

The question now arises as to what sales and transfers are subject to tax. Section 113.31 says that all sales, agreements to sell, and transfers with or without benefit to the transferee, whether effected by means of certificates or other instruments or by entries on the books of the issuing corporation or other entity or otherwise. Examples of taxable transactions may be found under Section 113.33. Item (F) of this section states that: "Transfer from persons holding legal title as tenants in common, as joint tenants, or as tenants by the entirety, to the same persons separately to effect a partition, or from one person or two or more persons, whether or not including the transferor, as tenants in common, as joint tenants, or as tenants by the entirety (But see Section 113.34 (e) (2.)" is a taxable transaction.

This section causes considerable confusion, and errors are often made in computing the tax on a transaction where stock is registered in the names of joint tenants. If both or all tenants are living, and a transfer is made by one tenant to the other tenant, it is taxable, whereas, if one of the joint tenants dies, the stock would be transferred to the surviving joint tenant without payment of tax. Joint tenants are considered as possessing one joint title and upon the death of one tenant his interest therein is extinguished and the title is considered as continuing in the surviving joint tenants or vests wholly in the surviving tenant if there be but one. In the case of tenants in common, however, there is not just one joint title but such tenants hold by several and distinct titles and the death of one will not extinguish his title, but will cause it to descend to his heirs or next-of-kin or legal representative in conformity with the laws of the state of his domicile.

Under Section 113.34, examples of transactions not subject to the tax may be studied. Other specific exemptions are provided in Sections 113.35 and 113.36. One of the provisions under Section 113.35 deals with the transfer from a broker to a customer, and states that the mere delivery of a certificate of stock by a purchasing broker to his customer, if tax was paid upon the sale of the stock to such broker who has no ownership or interest therein, is not subject to stamp tax and does not require an exemption certificate.

In the case of transfer by a broker or his registered nominee, the certificate(s) should have a certification stating, "It is hereby certified that the transfer of _____ of the shares represented by this stock certificate to the name indicated is made solely to complete the purchase made by the undersigned for a customer," and must be signed by the broker. A similar certification must be made when a transfer is made by a broker to his registered nominee. A transfer from the name of a purchasing agent other than a broker, such as a bank, whether the purchase be made direct or through a broker from the agent's account, will be subject to tax, since the exemption applies to deliveries and transfers from brokers only.

When the tax is paid at the lower rate, either because the selling price was under $20 per share or if it was a gift or a bequest where no sale was involved, then there should be a certification to this effect on either the back of the certificate itself or the stock power, if one is used by the transferor of the stock. The certification should state that the undersigned certifies that the transfer of the within shares does not constitute a sale, and tax therefore is paid at the lower rate, or it is a sale in which the selling price was less than $20 per share, the certification should so state.

The transfer agent not only must see to it that the correct amount of tax is paid, but also must see that the stamps affixed are either "Stock Transfer" or documentary stamps (ordinary postage stamps cannot be used), that they are affixed to the proper paper (usually the actual certificate(s) but sometimes to the book itself if evidence of transfer is shown only by the books of the Corporation), and last but not least, that the stamps are properly cancelled. Section 113.33 governs the cancellation of stamps, and provides that "A person using or affixing a stamp shall cancel it and so deface it as to render it unfit for reuse, by marking it with his initials and the day, month, and year when the affixing occurs. Such marking shall be made by writing or stamping in ink or by perforating with a machine or punch. In addition, unless a stamp of the value of 50

(Continued on page 18)

(Continued from page 6)

Adequate Methods

Hand in hand with adequate accounting records is the matter of internal control. A system of internal control implies that accounting records, procedures and related details are organized in such a way that no part thereof is under the absolute and independent control of one person, but rather that the routine work is so interlocked that individual duties are interdependent, and that a more or less continuous check on day-to-day transactions is provided. The objectives of such a system are to minimize the possibility of error and to provide for the speedy detection of fraud.

Have your accountant help you with the application of the basic principles of internal control to your business. Good internal control is important to your business not only from a business standpoint, but also from a moral and ethical one. "Let us not lead them into temptation." Most defalcations are the result, at the beginning, of small temptations. From a moral standpoint, embezzlements and defalcations are usually only thought of from the employer's standpoint. But have we ever given real consideration to what happens to the unfortunate employee? Not only has the employer suffered a loss, but a human being may have been ruined for life. It is my opinion that in many cases of defalcation, the fault lies partly with the employer who let a small person, and by small I mean small in character and in thinking, get involved in a situation where the temptation was too great for his strength; where adequate internal control would have lessened the temptation and probably have prevented a loss not only to the business but also the loss—ruin of a human being who could have remained a fairly valuable employee.

There is also a 'gray' area in this sort of situation, where an old and valued employe has not done any serious embezzlement, but he has more or less succumbed to petty temptation. What happens? An old and valued employee is fired under a cloud and with a good deal of embarrassment and many times real regret on the part of the employer. This creates bad morale among all employees, and bad morale costs money. Internal control is helpful in protecting the employee from himself and in saving the employer money.

To summarize the main topics of this discussion, your accountant by reason of his education, experience and independent viewpoint is well qualified to assist you in making a wide variety of management decisions, in providing a system of adequate records and procedures, and establishing adequate methods—or internal control.

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(Continued from page 15)

cents or more is cancelled by perforation, three parallel incisions shall be made lengthwise through the stamp with some sharp instrument after the stamp has been affixed. However, the stamp shall not be so defaced as to prevent ready determination of its denomination and genuineness."

Truly, the accountant's responsibility regarding transfer taxes is no small matter and should not be ignored.

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(Continued from page 17)

and should be guided by the progress of the older professions.

Because we are the fastest growing profession in the nation, we are falling heir to the difficulties experienced by some of these older professions during their development. And perhaps the first lesson is that a period of growth is a good time to redouble our professional vigilance. Other professions suffered from a few unethical practitioners who took advantage of the laxity that generally accompanies expansion.

Today, many businesses and some professions are coming to grips with the problems born of inadequate self-regulation. It is common knowledge that government regulations begin where self-regulations end. While government regulation is sometimes necessary, I doubt that any of us would like our Federal officials to assume the complete regulation of our profession. No one knows our needs and limitations better than we.

This brings us to the final similarity of our code to those of other professions: The effect it has on public opinion. A code of ethics over a period of time tends to become a stamp of integrity. Membership in a professional association which demands high standards of conduct is recognized as voluntary acceptance of the responsibility for right action. A code of ethics, particularly if well publicized, is a major factor in bringing about public acceptance. This is best exemplified by the tremendous effect the Hippocratic Oath has had in assuring the public of the doctor's standards of conduct.

As our profession expands in numbers and in usefulness, we are becoming increasingly aware of the fact that a well-defined code of ethics is an asset to us and to society. It helps us earn our daily bread—and our place in the sun.